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SUBJECT: NEW CAPITAL MARKETS LAW WILL IMPROVE OVERSIGHT,
BUT MARKET MANIPULATION STILL A PROBLEM

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¶1. (U) Officials of the Croatian Financial Markets Regulatory Authority (HANFA) have explained to Econoff the provisions of the new capital markets law that came into effect earlier this year. According to HANFA, the law brings Croatia 99 percent into harmonization with EU regulations under the EU Markets in Financial Instruments Directive (MIFID). Among other things, the law increases capital adequacy requirements for investment firms, requires companies offering investment services to have a local presence, and incorporates the other pillars of the EU financial services action plan. These include the Prospectus Directive (which eventually will allow a financial product prospectus approved in Croatia to be used elsewhere in the EU and vice versa), the Market Abuse Directive (which sets standards in the fight against market manipulation schemes), and the Transparency Directive (which establishes reporting requirements for listed companies). HANFA officials told us only small inconsequential differences remain between EU and Croatian regulations.

¶2. (U) Previously, regulation of investment firms in Croatia was minimal. The HANFA officials admit that the new capital adequacy, organizational, and reporting/transparency requirements will prove to be a strain for many firms. Thus, they expect to see (and in some cases are seeing already) the closure of small "mom and pop" investment houses, and the merger of others. HANFA has also stepped up inspection activities to ensure broad compliance with the new regulations. HANFA says the new regulations have been accepted in the industry with little complaint.

¶3. (U) Despite the new regulations, market abuse remains a significant challenge for HANFA, as well as the Croatian justice system. HANFA complained that there is a persistent lack of expertise or understanding in the courts of complex market manipulation schemes, resulting in few convictions and minimal fines. Croatia's stock market is small, with relatively low trading volume, meaning that would-be market manipulators can more easily influence short term market movements. They also complained that the cases are still the jurisdiction of administrative courts, which handle numerous types of misdemeanor offenses and are not adequate to deal with large-scale financial crimes. Despite their frustration, they reported at least one positive development in the stock market. Croatia has just signed a contract for a powerful software package currently in use by the London Stock Exchange that analyses large volumes of trade data for suspicious patterns. HANFA is anxious to make use of the software as they feel it will greatly enhance their capabilities to detect various forms of fraud.

¶4. (U) COMMENT: Market abuse is yet another area where Croatia's court system shows its inadequacy to deal with complex economic crimes. In addition to the persistent

delays that plague cases throughout the court system, financial crimes cases are usually assigned to relatively low-level administrative courts notorious for imposing minuscule fines for behavior that might have reaped millions for the perpetrators. Recent legislation will soon give the Croatian Market Competition Agency (AZTN) unprecedented powers to levy painful fines to combat monopolistic behavior (see reftel). HANFA currently only has the power to suspend licenses for financial services companies who fail to comply with regulations, but would benefit greatly from a similar, more punitive, authority to levy large fines. END COMMENT.
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